

# Development Feasibility: The Entrance

Report

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# 1 Introduction

## 1.1 Background

Development is occurring rapidly on the Central Coast. The Entrance is an important coastal centre within Wyong Shire and has experienced an increase in the development of medium/high density housing following the redevelopment of the town centre and the recent housing boom.

Existing planning controls for the Entrance have been in place since 2000. However, since the introduction of the new planning provisions, some developers have claimed that the controls applying to the higher density zoned land are so restrictive as to make development not economically viable. This study is aimed at testing the validity of these claims. This investigation will feed into a broader strategic study of The Entrance and will enable Council to understand the limits to growth.

## 1.2 Local Context

In recent years, The Entrance has faced significant development pressures. The Entrance Strategy was put in place in 2000. Following the housing boom and the renewal of the town centre in 1997, a significant amount of development has occurred, in the form of high-rise multi-unit dwellings.

Discussions with local real estate agents indicate that the slow down in the property market, combined with additional supply of units being developed, has resulted in a degree of oversupply within the local market. Sales statistics indicate in the six months to March 2006, on average units were on the market for 51 days. This is quite low and represents a significant decrease from the six months prior in which the average was 112 days for the suburb, compared with 107 days, across the Central Coast as a whole.

In the six months prior to September 2005, the median price for units at The Entrance was \$400,000, the median price recorded for the following six months was \$325,000, a decrease of 19%. Over the same time period, across the Central Coast, the median sale price fell from \$305,000 to \$300,000.

## 2 Method

### 2.1 Research Process

Through discussions with Council, SGS identified suitable 'case study developments'. These case studies were chosen to highlight a range of development outcomes. Through an examination of the Development Application documentation and the Statement of Environmental Effects, as well as through consultation, SGS was able to document the development details in each case including floorspace, product type, sales values, land values and estimated take up rates.

In addition, this study has examined the feasibility of a range of development options for key sites in the town centre which have been prepared by Dickson Rothschild.

Existing property data, such as Australian Property Monitors, has been supplemented with information obtained through real estate agent consultations. Construction costs have been estimated using a combination of Rawlinson's Construction Manual data and advice provided by Bay Partnership quantity surveyors.

From this range of sources, estimated costs and returns have been identified.

### 2.2 Residual Land Value Model

SGS has developed and run a residual land value (RLV) test for each case study. The RLV test includes:

- Potential revenue from development.
  - Achievable sales prices minus selling expenses
  - Achievable rental values
  - Developer margin.
  
- Costs of development.
  - Construction cost
  - Demolition cost
  - Professional fees
  - Council fees
  - Holding costs

The output from the model, the residual land value, reflects the price at which it is feasible for a developer to purchase the land. Should the RLV be greater than the market value<sup>1</sup> of the land, the development is not feasible.

Valuations for each of the sites were supplied by Council.

Output of the RLV model is discussed in Section 3. Key sensitivities in the estimated costs and returns for the case studies and development options are highlighted and the most important factors influencing profitability of developments are discussed. Council's planning controls are considered in this context.

## 2.3 Model Inputs and Assumptions

The inputs used in the RLV modelling are described below in terms of development revenues and expenses. Other assumptions are also described.

### 2.3.1 Development Revenues

The sites being tested are in a highly visible location in the Town Centre with a high level of passing trade and a sunny aspect. The assumptions included regarding the potential revenues from the development are described below.

#### **Sale Prices**

Sales values are a major determinant of development feasibility of a proposed development. Recent sales for residential development were obtained from real estate websites. The median unit sales price in The Entrance from October 2005 to March 2006 was \$325,000. This is a significant decrease from the previous six months when the median price was recorded as \$400,000. Historical sales values have been gained through consultation with local agents. Residential sale prices are influenced by many factors and actual returns from the development of residential units in The Entrance will vary according to the responses to the following questions.

1. What is the overall level of demand for units in The Entrance?

This is related to how the Entrance town centre was positioned at the time of DA lodgment for the case studies. For the Dickson Rothschild options, it is related to the current positioning of the centre. Consultation suggests that within the residential market there are different levels of demand for various product types. At present there is an oversupply of units on the market, and the supply is likely to increase over the next 18

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<sup>1</sup> As market valuations were not available at the time of the study, unimproved land values have been used as benchmark for RLV testing. In reality, the market value of the land is likely to be higher than the unimproved value.

months. The availability of units will have a significant impact on the achievable prices for any proposed development containing this product type.

2. What is the type of residential product in demand?

For example, one or two bedroom units being sought by young professionals compared to larger properties being sought by established families or retirees.

3. How does the proposed development compare to the existing offer in The Entrance?

The sale price for a new development, is likely to be higher than that for an older development. In recent years a large number of apartments have been developed at The Entrance. These developments have tended to be large apartments with high quality finishes and particularly during the housing boom, these properties achieved high sale prices. There is some older stock within The Entrance consisting of three storey walk-ups.

4. What is the quality of the development being proposed?

The overall quality of the end product will depend upon the grade of internal finishing, provision of car parking, outdoor areas (balconies), common facilities such as gymnasiums, spas/saunas or pools, security, views and outlook, aspect, noise and the level of amenity offered in the Town Centre.

Sensitivity testing is completed by increasing and decreasing the property sales prices by 10 percent.

It is suggested that further analysis be prepared at a later date to take into consideration more detailed information on the proposed development including the market positioning of the town centre and the quality of finishes.

### **Commercial/retail rental returns**

Current advertised property rentals and historical values were obtained from real estate websites and through discussions with real estate agents. High, medium and low achievable rental rates were used to test the sensitivity of the model.

### **Capitalised values (commercial)**

For established buildings or for properties with expected capital gains or redevelopment potential, purchases may be made where rent returns are as low as 7 to 8 percent. The visibility and passing trade would be an attractive advantage to any retail and commercial activities on some, but not necessarily all of the study sites.

Sensitivity testing was undertaken by increasing and decreasing the estimated commercial/retail property values by 10 percent.

## **Other Selling Expenses**

Allowances are made for commission on sales, professional fees, and marketing – selling expenses total 4% of the development value.

## **Profit and risk**

An allowance has been made for developer profit and risk. This has been set at 15% of the sales value. For some options on Council owned land there may be an opportunity to reduce profits for the sake of development proceeding. In these cases, sensitivity testing has been completed with the allowance zero profit in the modeling.

## 2.3.2 Development Expenses

### **Professional Fees**

Allowances are made for architects, engineering (civil, structural, mechanical, hydraulic, electrical), survey fees, quantity surveyors and project management. These will vary to some degree according to the nature of the project but usually amount to around 9% of the development cost.

### **Building Costs**

The costs of construction are based on construction data and advice from quantity surveyors. The costs included in the analysis are indicative only and are not based on any design or specific site information. We stress that these costs are an opinion of probable costs only and we strongly recommend that they be used for comparative analysis purposes only, it is suggested that further cost estimates be prepared at a later date to incorporate specific design and planning details in conjunction with information provided by the Architect, Structural and Services Engineers.

The costs used do not allow for site preparation, staging costs, abnormal ground conditions, fitout of retail and commercial tenancies, external works, external services and mains connections, landscaping, special equipment, etc. Separate allowance is made for land costs, professional and local authority fees and charges, marketing and legal costs, finance costs etc.

The analysis includes a contingency value of 10 percent of the construction costs. This is considered appropriate given the preliminary nature of the assessment.

Sensitivity testing is completed by increasing and decreasing the construction costs by 10 percent.

## Other Costs

Allowances are made for council DA fees, Section 94 fees, PlanFirst fee, strata title set up costs, holding costs (rates and land tax), water corp fees, electricity, gas and bank charges. These are calculated on a project by project basis. The value of 'other costs' can vary significantly from project to project within the range of 5% to 12% of total development expenses.

### 2.3.3 Other Assumptions

- Timing                    24 months from construction to occupation
- Interest Rate            7 percent
- Land Values             These were not available from Council. A market valuation, completed by a local real estate agent or property valuer, would provide more reliable assumptions for the current land values in the Town Centre.



## 4 Issues & Conclusions

### 4.1 Sensitivity Analysis

Sensitivity analysis was undertaken to determine the impact of varying costs and revenues on the feasibility of each development.

#### **Cost Side Sensitivity**

On the cost side, the RLV is most sensitive to variations to the construction cost. Construction costs are likely to vary depending on a range of factors such as:

- The location and nature of the site – for example: access, the slope of the site, the depth of the water table etc;
- The nature of the development – for example: the level of finishes, extent of air conditioning, height of building, number and location of lifts, floor to wall ratio, type of façade construction and materials; and
- Other factors – for example: the distance from suppliers and availability of labour, the cost associated with solving any groundwater issues relating to providing adequate basement vehicle parking facilities, and the like.

Advice provided by Bay Partnership has indicated that construction costs may vary by 10-15% based on the factors listed above. Taking this into account, sensitivity testing was undertaken to test the impact of varying construction costs by 10%. These results have been included in the tables in the previous section.

For some of the proposed developments, the RLV model has also been run without an allowance for 'developers profit' – typically this is included in the calculations. Should Council decide to undertake any of these developments, achieving a profit may not be imperative - e.g. if public parking is being provided at a benefit to the local area. The removal of profit from the model may make some options more feasible.

#### **Revenue Side Sensitivity**

On the revenue side, the RLV is most sensitive to changes in the achievable price. Prices are influenced by:

- The nature of the development and how it compares with other available housing stock;
- The volume of competing supply which is available at the time of sale; and
- The nature and volume of demand for apartments.

Supply and demand will be driven by a range of factors such as the relative desirability of The Entrance as a place to live, property prices elsewhere, influxes of retirees or people seeking a

lifestyle change. Agent consultation suggests that there is an oversupply of residential units in the area against current demand. This affects achievable prices (and thus feasibility).

At a coarse level of analysis, and assuming enough strength in demand, higher buildings will tend to show greater development feasibility. However, higher built form does not necessarily have a linear relationship with development feasibility. Broadly speaking, on the revenue side, units at the top of a development will be able to achieve better premiums as a result of views. However, the construction costs of high rise development are also greater. High, medium, and low property price estimates have been generated for the case studies and proposed developments.

### **Sensitivity Analysis**

The sensitivity analysis indicates that the achievable property price has the greatest influence on the feasibility of developments. The nature of the market at the time at which the development is undertaken is thus the key determinant of feasibility of each development.

### **Further Issues**

For the sites that are currently occupied by car parking unimproved land values may be a reasonable benchmark to test the RLV against. Unimproved values take into account the 'speculative component' of the value, but will be based on the current planning controls. Should a sale take place, the price that may be asked or paid may be higher than the Valuer General's estimation depending on the number of buyers who are speculating and any degree of uncertainty in relation to the planning controls.

## **4.2 Role of Planning Controls in Feasibility**

While the unavailability of improved (market) land values prevents SGS from being able to make firm conclusions on the impact of planning controls on development feasibility, a number of broad themes are evident in the existing analysis. These include planning fees, building height and the role of certainty and speculation in relation to land values.

### **Sensitivity of RLV to Variation in Planning Fees**

In general, planning fees (including development application fees and s.94 contributions) account for between 4 and 8% of the costs of a development, excluding the costs of land. In contrast, construction costs account for approximately 80% of the costs incurred by a developer, excluding the cost of land. Sensitivity analysis indicates that fluctuations in construction costs on the cost side, or fluctuations in sale prices on the revenue side, have a much greater influence on the feasibility of developments than planning fees. Construction costs are liable to vary by 10- 15%.

## **Planning Certainty and Land Market Speculation**

SGS experience, combined with consultation with local agents, indicates that perceived flexibility, or a belief that planning controls are likely to change, fuels speculation within the property market.

Speculation plays a key role in determining the potential sale price of land, as pricing is based on perceptions of what may be developed on the land in the future. Hence, Wyong Council may influence development feasibility within the Entrance by ensuring that planning controls are well defined and not subject to change. Thus, certainty in the planning regulations can reduce speculation and help to keep land values, permissible development, and development feasibility in line.